



**Washington State
Department of Transportation**

Draft

Guidance for Small Firms (And/or New to WSDOT)

(WSDOT & Local Agency Agreements)

WSDOT Internal Audit Office

July 2014

Guidance for Small Firms

(this also includes firms that are new to working with WSDOT & Local Agencies)

To get the most benefit from this guidance document, we suggest that you watch the [Basic Timekeeping Webinar](http://www.wsdot.wa.gov/Audit/guides.htm) prior to review of this document, the link to which can be found at: <http://www.wsdot.wa.gov/Audit/guides.htm>

PREFACE

This guidance document is geared toward small A/E firms, and/or firms that are new to contracting with WSDOT and Local Agencies ¹ for A/E service to provide them with overall indirect cost rate guidance and provide them with the following:

- *Knowledge and understanding of the necessary documentation for:*
 - *Supporting their direct and indirect costs,*
 - *Establishing the necessary Controls*
 - *Processes to succeed in complying with the FARS, the AASHTO Audit Guide,*
- *Assistance in complying with WSDOT's agreement terms and conditions.*

Our goal is to make the process of working with the agency smooth and successful. As a step in contracting with WSDOT or Local Agencies, coordinating with the WSDOT Audit Office is essential to help ensure firms have, or are willing to implement, the policies, practices and procedures that are necessary when working under a WSDOT agreement.

Our experience in this area has provided us with insight to some of the frequent challenges that firms may experience, especially smaller firms or those firms that are new to working with a government agency. Please see the [Audit Office Web page](#) for contact information and feel free to call with questions.

¹ The reference to Local Agencies in this document refers to Federal money that WSDOT provides for Local Agency agreements (city and county) for transportation-related projects.

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Chapter 1 - Timekeeping

Timesheets are the source documents to support labor billed. The reliability and accuracy of a consultant's labor charging system is extremely important. Implementation of an electronic timekeeping system is NOT a necessary requirement. Manual timesheets are acceptable as long as the necessary processes & controls are in place and are followed. All firms, whether they are a prime consultant or a sub-consultant, are expected to have detailed timesheets to support all labor, regardless of the firm's size. This also applies to firms with only one person.

Each firm should have a **written timekeeping policy** or pamphlet. Timesheets should meet the timekeeping requirements as discussed in the AASHTO Audit Guide, Chapters 5 and 6. See Attachment A for sample manual timesheets, Attachment C for AASHTO Audit Guide Chapters 5, F. Internal Labor Costs, and Attachment D for AAHSTO Audit Guide Chapter 6, B. Labor Charging System Internal Controls.

Consultant's timesheets should record, and their timekeeping policy should include, the following (*this is not an all-inclusive list*):

- All hours worked by all staff, including owners/principals, should be recorded on the timesheets daily.
- Time spent on projects (including non-billable project labor)
- Time spent conducting administrative tasks
- Paid and Unpaid leave
- All hours worked, whether paid or not.
- Direct and Indirect labor must be segregated (administrative time should be recorded, as well as paid time off).
- The employee should have sole access to create his/her timesheet.
- We should be able to verify supervisory approval of the timesheets (this would not be applicable in very small one or two person firms).
- The supervisor should not be able to enter or make changes to employee timesheets without the employee's approval. Any changes to hours recorded on the timesheet must be evidenced by both employee and supervisor approval (initialed/dated in ink by employee and supervisor).
- Firms must have a written process to document any corrections to hours that were recorded on timesheets. (For 1 or 2 person firms this may not be necessary.)

Timesheets should indicate at a minimum the hours worked by project numbers, contract number or name, or other identifiers for a particular assignment. If your firm is working on a WSDOT Task Order Negotiated Hourly Rate Agreement, your timesheets must show the task information as well as the agreement identification.

Reference [WSDOT Interpretive Guidance for Labor](#)

Chapter 2 - Support for Raw Labor Rate

Hourly billing rates² for each person/classification are determined based on three components

- Employee's Actual Payroll Rate;
- Firm's Indirect Cost Rate (overhead); and
- Fixed fee.

Per the terms and conditions of the WSDOT agreement, each employee working on the agreement should be billed at a rate that is based on their actual raw labor rate. In the example below, John Doe's actual raw labor rate is \$60, and this hourly rate is supported by the firm's payroll register or equivalent payroll records. The hourly billing rate is \$135 per hour.

Example:

<i>Classification</i>	<i>Raw Labor Rate</i>	<i>Overhead (ICR) 105%</i>	<i>Fixed Fee 20%</i>	<i>Billing Rate</i>
<i>John Doe, Principal</i>	<i>\$60.00 *</i>	<i>\$63.00 *</i>	<i>\$12.00 *</i>	<i>\$135.00</i>

*In your situation, the employee's actual raw labor rate, overhead and fee may be different. The above is meant to be an example only.

The documentation that is available to **support** an individual employee's or principal's raw labor rate varies from firm to firm. Many firms have payroll registers which show each person's actual rate of pay, and whether they are hourly or salaried. For very small firms, we often see other methods of payment for the sole-proprietor, such as: checks that were taken as a draw, or amount for draws shown on Financial Statements.

For **salaried staff** the raw labor rate is determined using salary divided by the standard 2,080 hours per year. For example, Jane Fox is paid \$100,000 per year per the payroll register. Divided by the standard 2,080 hours this equates to a raw labor rate of \$48.08.

We have worked with one-person firms who do not work the full 2,080 hours per year. These one-person firms typically take draws to pay themselves. **Total draws** for the year divided by the total hours worked for the year equals the raw labor rate. (Total hours worked includes both project (direct) hours and administrative hours). If the one-person firm has not kept timesheets for the year, we will work with the individual to estimate the hours worked for the year to compute the raw labor rate. We will also provide the firm with timekeeping instructions, and our expectation is that a timekeeping process will be implemented.

² Billing rates as agreed to in the applicable prime or sub-consultant agreement

Chapter 3 - Indirect Cost Rate

Each firm who works with WSDOT or a Local Agency is required to have an **Indirect Cost Rate (ICR)** to bill administrative costs to WSDOT or Local Agency agreements. Firms that have not developed an indirect cost rate may qualify for the **Safe Harbor Pilot Program**. The Safe Harbor rate is 110% and enables the firm to begin work immediately, if the firm opts to accept that rate, and is eligible to participate in the [Safe Harbor Program](#), as they work to establish the necessary accounting system and controls on the Pathway to Compliance.

Indirect Cost Rate Schedule

The indirect cost rate schedule is the primary document used to show the calculation of the firm's non-direct costs. A firm's ICR should be shown in the standard [WSDOT format](#) and is based on your firm's account titles & dollars. The amounts on the ICR should tie to other financial documents for the period. See Attachment B for a sample indirect cost schedule.³

The WSDOT Audit Office reviews a firm's Indirect Cost Rates. When a firm submits a qualifying proposal on an agreement, it is our expectation that the firm has a current FAR-compliant Indirect Cost Rate (ICR) and is ready to go to work, or is interested in being part of the Safe Harbor program. A FAR-compliant schedule should have all unallowable costs and the directly associated costs removed from it. The [AASHTO Audit Guide](#) has good guidance if you are not sure if an item of cost is allowable: Page 84 of AASHTO lists common unallowable costs, and Appendix C, in the Guide, shows items of cost and if they are generally allowable.

CPA-Audited Indirect Cost Rate

Your firm may have a CPA audit your indirect cost rate. The costs of this audit are allowable in your indirect cost pool and, therefore, are recoverable through your indirect cost rate. If your firm has a CPA-Audited ICR, please provide a copy of your CPA's report (including all notes) and the associated rate schedule to the WSDOT Internal Audit Office.

Cognizant Letter

A Cognizant Letter (also known as a "Cog" Letter) is a letter from a state DOT that has audited your indirect cost rate, or that has reviewed work of your CPA-audited rate. The letter issued by the state DOT says "cognizant" in the letter. If you receive such a "Cog" letter from another state DOT, please provide a copy of the letter, along with a copy of the associated indirect cost schedule to the WSDOT Internal Audit Office. Once WSDOT receives a copy of a "Cog" Letter and the associated indirect cost schedule by another state, we need do nothing further to complete our indirect cost rate review.

³ Attachment C is an example of an indirect cost schedule; the accounts on your firm's actual indirect cost schedule may differ from the ones in the example. The accounts are made up the actual accounts your firm uses in its cost accounting system.

Labor component of the Indirect Cost Rate Schedule & Labor Reconciliation

For very small firms that do not have some of the key labor reports mentioned below, such as a Payroll Register, the process to reconcile labor costs may be different than described below.

(For one or two-person firms this process will be modified, and we would explore what documentation the firm has available). Feel free to call us at (360)705-7003 with questions.

The dollar amounts and account titles for a firm's ICR should come directly from the Income Statement or accounting general ledger accounts for the period. The total labor amount shown on the ICR must tie to a firm's payroll register for the period. It is important that each employee's labor as recorded on the timesheets and in the payroll records match. We have developed a format which can help with this process: The Labor Distribution Report (LDR) shows all hours, dollars for the year and is broken out by individual employee. Your firm may have other labor reports that may work to ensure that the payroll records match the financial statements/tax records and the indirect cost rate schedule.

The matching (reconciliation) of the four documents below is necessary and provides assurance and verification that the labor costs on the Indirect Cost Rate schedule are actual and correct.

Those four documents are:

- Indirect Cost Rate Schedule (ICR)
- Labor Distribution Report (LDR) ⁴
- Income Statement/Tax Records
- Year-end payroll register, shown by individual employee

Labor is the largest component on a firm's ICR, and we use this four part verification for assurance that the firm's labor is reconciled for the year and that the labor is based on the correct amounts. A firm's accounting system, job-costing system, and labor charging system serve as the basis for the Indirect Cost Rate Schedule (ICR). The direct labor is the base for calculating the ICR rate. When the ICR ties to Payroll Register to the Income Statement and to LDR this is good news!

If a firm's labor is not reconciled for the year, and the four documents do not match – the Audit Office will typically not be able to complete a review of your Indirect Cost Rate.

Regular reconciliation of labor costs to payroll, at the level of individual employee, is extremely important to this process it will save you time at year-end and is considered a “best practice.” Reconciliation after each payroll period is ideal. Waiting until year-end to complete your labor reconciliations could be equated to waiting until year-end to reconcile your bank account to see

⁴ For more details about the LDR, please see our [Interpretive Guidance for Labor](#).

how much money you have left. The guidance in the AASHTO Audit Guide notes that reconciliations should occur no less frequently than once every thirty days. Our office prepared an example LDR worksheet that can be used for these monthly reconciliations. We find that firms that are waiting until year end to reconcile their labor have a difficult time matching all of the totals and creates more work for all involved in the ICR Review

Some of the current labor/timekeeping issues that we see challenging to small firms when reconciling labor costs include:

- Use of furlough days.
- Staff working less than scheduled hours.
- Reduced work hours and/or reduced pay.
- Comp time taken in excess of the comp hours earned.
- Hours paid but not worked.

Chapter 4 - WSDOT Agreement Criteria

Costs that are reimbursed through WSDOT agreements are limited by the specific criteria noted in the **agreement**. The criteria in WSDOT agreements apply to all firms regardless of a firm's size, and apply to sub-consultants as well as to the prime consultant. The following is a high-level summary of portions of the agreement language.

Section V Payment Provisions of the standard WSDOT Agreement requires compliance with all applicable portions of the Federal Acquisition Regulations (FARs) in [48 CFR Part 31](#).

48 CFR 31.201-2 (d) A contractor is responsible for accounting for costs appropriately and for maintaining records, including supporting documentation, adequate to demonstrate that costs claimed have been incurred, are allocable to the contract, and comply with applicable cost principles in this subpart and agency supplements. The contracting officer may disallow all or part of a claimed cost that is inadequately supported.

Section V, Payment Provisions, A. requires the consultant to have support data for verification for components of the hourly rates, this includes the raw labor rate and the indirect cost rate.

Section V, Payment Provisions, B states that direct non-salary costs must be billed at actual cost and must be supported by documentation. Travel costs must be billed in accordance with the [WSDOT Accounting Manual, M13-82, Chapter 10 Travel](#) .

Section V Payment Provisions, F. states that consultants (including sub-consultants) must have available for inspection any cost records up to three years after the final payment is made on the agreement. (For example, if you are a small firm, working as a sub-consultant on a WSDOT agreement briefly in 2013, but the prime's agreement runs until 2016 with final payment in June 2016, you would be required to have all related records available for an audit through June 2019.)

Section VI Sub-Contracting notes that all sub-consultants must be pre-approved, and are subject to the same audit criteria as the prime consultant.

Please refer to your individual WSDOT Agreement to become familiar with the various sections mentioned above. Your agreement or sub-agreement should have sections similar to these.

Closing Note

We encourage you to phone our office at (360) 705-7006, if you have questions. We can offer one-on-one training and assistance to your firm, if requested.

We have additional Interpretive Guidance documents available at the following link:

<http://www.wsdot.wa.gov/Audit/guides.htm>